

Supporting Statement for the
Consolidated Bank Holding Company Report of Equity Investments in Nonfinancial
Companies (FR Y-12; OMB No. 7100-0300)

Summary

The Federal Reserve will implement the mandatory Consolidated Bank Holding Company Report of Equity Investments in Nonfinancial Companies (FR Y-12; OMB No. 7100-0300). Bank holding company (BHC) investments in nonfinancial companies have increased significantly over the past several years. The Gramm-Leach-Bliley Act (GLB Act) of 1999 broadened the scope of permissible investments in nonfinancial companies. The FR Y-12 will collect information from certain domestic bank holding companies on their investments in nonfinancial companies on three schedules: Type of Investments, Type of Security, and Type of Entity within the Banking Organization. Large bank holding companies will report on a quarterly basis and small bank holding companies will report semi-annually. This information will enable the Federal Reserve to monitor the exposure of bank holding companies to these investments on a timely basis.

A copy of the FR Y-12 reporting form and instructions is attached. The estimated annual burden for this report is 14,112 hours. The Federal Reserve will implement this report as of September 30, 2001.

Background and Justification

BHC investments in nonfinancial companies have increased significantly over the past several years. These investments have contributed significantly to earnings and capital at institutions actively involved in this business line. Equity investments also have contributed to the volatility of earnings and capital in recent periods and have increased some institutions' risk profiles. The GLB Act permits financial holding companies to make investments in any amount in any type of nonfinancial company as part of a securities underwriting or merchant or investment banking activity. The investments permissible under the GLB Act's merchant banking authority are substantially broader in scope than the investment activities otherwise permissible for BHCs. Thus, these investments present the potential for additional volatility and risk in banking organizations' portfolios.

The FR Y-12 will provide valuable supervisory information that will permit examiners and other supervisory staff to monitor the on-going growth and contribution to profitability of this increasingly active business line. For institutions active in this business line, annual reviews generally are conducted. The FR Y-12 will serve as an important risk-monitoring device for institutions active in this business line by allowing supervisory staff to monitor an institution's activity between review dates. It also could serve as an "early warning" mechanism to identify institutions whose activities in this area are growing rapidly and that, therefore, may warrant special supervisory attention.

On January 31, 2001, the Board and the Treasury Department published a final rule in the *Federal Register* on merchant banking investments made by financial holding

companies (66 FR 8466). In Section 225.175 of this final rule, the Board stated that reporting forms to fulfill the quarterly and annual reporting requirements associated with this rule would be published separately. Institutions would not be held responsible for these reporting requirements until the reporting forms are finalized. This proposal covers the quarterly reporting requirements; the reporting forms for the annual reporting requirements will be addressed in a separate proposal later this year. The annual report will obtain information on merchant banking investments that have been held for an extended period of time.

Description of Information Collection

The FR Y-12 will provide valuable information on the types of investments made by BHCs and their subsidiaries in nonfinancial companies (excluding investments held in trading accounts). This report will be filed by each top-tier domestic bank holding company that:

- files the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C; OMB No. 7100-0128),
- has aggregate nonfinancial equity investments that equal or exceed the lesser of \$200 million (on an acquisition cost basis) or 5 percent of the BHC's consolidated Tier 1 capital as of the report date, and
- has made an effective election to become a financial holding company *or* directly or indirectly has an Edge corporation, agreement corporation, or small business investment company subsidiary *or* holds equities under section 4(c)(6) or 4(c)(7) of the Bank Holding Company Act.

This report will also be filed by each top-tier domestic bank holding company that:

- files the Parent Company Only Financial Statements for Small Bank Holding Companies (FR Y-9SP; OMB No. 7100-0128),
- has aggregate nonfinancial equity investments that equal or exceed (on an acquisition cost basis) 5 percent of the BHC's total capital as of the report date, and
- has made an effective election to become a financial holding company *or* directly or indirectly has an Edge corporation, agreement corporation, or small business investment company subsidiary *or* holds equities under section 4(c)(6) or 4(c)(7) of the Bank Holding Company Act.

To determine whether or not a BHC will have to report the FR Y-12, questions will be added to the FR Y-9C and FR Y-9SP forms for the criteria listed above, prior to the implementation of the FR Y-12.

There are three schedules on the FR Y-12: Type of Investments, Type of Security, and Type of Entity within the Banking Organization. The data to be collected in each schedule are discussed below.

Schedule A, Type of Investments

Schedule A of the reporting form will collect information on whether investments are made directly in public or nonpublic entities or indirectly through investment funds. Columns A, B, and C will collect information about direct investments in public entities and nonpublic entities and all indirect investments (fund investments). Column A of this schedule will collect information on the acquisition cost. Column B will collect important information on net unrealized holding gains not recognized as income. The Federal Reserve conducted interviews with several large banking organizations with significant equity investments to get feedback on the form and instructions prior to implementation. Even though Column B was not a part of the reporting form at the time of the interviews, nearly all institutions agreed that providing this information would not significantly increase the reporting burden. Given the importance of this information in determining the quality of capital at institutions engaged in equity investment activities, the Federal Reserve will include this column. Column C will collect the carrying value, by category of investment. Column D will collect the aggregate publicly quoted value for direct investments in public entities.

Memorandum item 1 will include check boxes for the number of companies in which investments are made for the entire portfolio, in order to provide a very general picture of the degree of diversification. Information obtained from on-site reviews of this business line will be necessary in order to understand completely the diversification of a BHC's portfolio. However, the information obtained on the FR Y-12 will provide some indication of diversification, at least for those companies reporting a small number of companies, but a large dollar amount of investment. For indirect investments, the institution should count the number of investment funds in which the BHC has an equity investment.

Memorandum item 2 will collect data on investments made under the new merchant banking authority, so that examiners and other supervisory staff will have a clear picture of the number and dollar amount of "legacy" investments and investments made under the new authority. Information on merchant banking investments is currently collected on the FR Y-9CS, Supplement to the Consolidated Financial Statements for Bank Holding Companies (OMB No. 7100-0128) and will be removed from this supplement upon the implementation of the FR Y-12.

Memorandum item 3 will collect data on consolidated recognized gains or losses on equity investments in nonfinancial companies. This item was included for purposes of determining what portion of a BHC's consolidated net income is derived from equity investment activities.

Schedule B, Type of Security

Schedule B will collect information concerning the type of security held by the reporting institution (for example, common stock, convertible debt) and provide the acquisition cost (Column A) and carrying value (Column B) of these investments.

Different rights accrue to the holders of different types of securities, and thus, this is important information in determining the risk profile of an institution's holdings. Memo item 1, Unused Equity Commitments, will collect helpful information on the full exposure of an institution to this business line.

Schedule C, Type of Entity within the Banking Organization

Schedule C will identify the type of company in the BHC structure through which the investments reported in Schedules A and B are held (for example, broker/dealer, SBIC, or Edge subsidiary). Column A will collect the acquisition cost, and Column B will collect the carrying value of these investments. Columns C, D, and E will break out the carrying values reported in Column B into direct investments in public entities, direct investments in nonpublic entities, and all indirect investments, respectively. The memoranda items will collect foreign versus domestic investments. No significant comments were received during the interviews with institutions on this Schedule. Columns C, D, and E were added after the interviews were completed. However, the Federal Reserve believes that respondents will be able to provide this information since the totals of each of these columns tie to Schedule A, items 1 through 3, Column C.

Time Schedule for Information Collection

The FR Y-12 will be collected as of the end of each calendar quarter for those BHCs that file the FR Y-9C and as of the end of June and December for those BHCs that file the FR Y-9SP. The FR Y-12 will be submitted to the Reserve Banks within 45 calendar days after the as-of date. Data from the FR Y-12 will not be published.

Legal Status

Section 5(c) of the Bank Holding Company Act authorizes the Board to require reports from BHCs to keep the Board informed of, among other things, their financial condition and risk management systems. Overall, the Board does not consider the data in these reports to be confidential. However, a bank holding company may request confidential treatment pursuant to sections (b)(4) and (b)(8) of the Freedom of Information Act [5 U.S.C. 552(b)(4) and (b)(8)]. Section (b)(4) provides exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential." Section (b)(8) exempts matters that are "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions."

Consultation Outside the Agency

The Federal Reserve conducted interviews with nine large banking organizations with significant equity holdings to obtain feedback on the forms and instructions. Several of the comments received during these interviews have been incorporated into the draft reporting form and instructions. A copy of the form was also provided to staff of the Treasury Department because the form will collect information on merchant banking investments.

Sensitive Questions

This collection of information contains no questions of a sensitive nature, as defined by OMB guidelines.

Estimate of Respondent Burden

The estimated annual burden for the new FR Y-12 report will be 14,112 hours as shown in the following tabulation. This represents less than 1 percent of total Federal Reserve System annual reporting burden. The Federal Reserve estimates that the FR Y-12 will be filed by 209 BHCs that file the FR Y-9C and 23 BHCs that file the FR Y-9SP and that on average these respondents will take 16 hours to complete the reporting form. Questions will be added to the FR Y-9C and FR Y-9SP forms to determine whether a BHC will be required to file the FR Y-12. This screening tool will reduce the reporting burden for BHCs that do not meet the reporting criteria.

	<i>Number of respondents</i>	<i>Estimated annual frequency</i>	<i>Estimated response time</i>	<i>Estimated annual burden hours</i>
FR Y-12:				
FR Y-9C filers	209	4	16	13,376
FR Y-9SP filers	23	2	16	<u>736</u>
<i>total</i>				14,112

Based on an hourly cost of \$20, the annual cost to the public is estimated to be \$282,240.

Estimate of Cost to the Federal Reserve System

The estimated cost to the Federal Reserve System for collecting and processing the FR Y-12 is estimated to be \$111,065 annually. The total one-time implementation cost for this report is estimated to be \$34,627.

ATTACHMENT 1

FR Y-12 REPORTING FORM AND INSTRUCTIONS